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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
Treatment of Operator Services Under Price Cap Regulation	)	CC Docket No. 93-124
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

COMMENTS OF
THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.

Daniel L. Brenner
Neal M. Goldberg
David L. Nicoll
1724 Massachusetts Ave., NW
Washington, D.C. 20036
(202) 775-3664

Counsel for the National Cable Television Association, Inc.

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THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.

The National Cable Television Association ("NCTA") submits the following comments in response to the Commission's notice of proposed rulemaking ("Second Further Notice") in the above-captioned proceeding.

NCTA is the principal trade association of the cable television industry. Cable companies are among the principal potential competitors to the incumbent monopoly providers of local telephone service. The actions taken here will profoundly influence the ability of potential competitors to compete with the incumbents.

INTRODUCTION AND SUMMARY

The Second Further Notice is an important step in the transition to competition. It seeks comment on the rate regulation frameworks that will apply as competitors offer alternatives to the LECs' service offerings, and the LECs respond to competition. It also seeks comment on the relationship of competition to the Commission's determinations to modify the elements of rate regulation.

Central to the Commission's approach is the notion that the implementation of price caps without sharing so reduces the threat of cross-subsidy that regulatory constraints can be significantly reduced. The Declaration of Dr. Leland L. Johnson, appended to these comments, explains however, that none of the price cap plans under consideration by the FCC or the states break the link between prices and costs. Since this link is not broken, the incentives and risks of cross-subsidy are still present, and regulators must continue to review service costs as well as service prices.

The continuing review of costs as well as prices is needed until LECs lose their bottleneck control of local telecommunications, and the ability to disadvantage competitors by misallocating costs and otherwise undertaking anticompetitive practices. Proposals in the Second Further Notice to alleviate regulation are premature and should be considered only when the LECs' bottleneck control over essential facilities is removed, mechanisms necessary to facilitate competitive entry are in place, and competitive forces are present that can effectively replace regulation. At the same time, the Commission must adopt special mechanisms to enable competitors to obtain relief on an expedited basis in cases where anticompetitive practices are demonstrated.

Finally, technological and marketplace circumstances counsel against "streamlining" or adopting "nondominant" status, even on a service-specific basis. Local competition is at its very earliest stages, the numerous mechanisms necessary to effectuate competition are not in place, and the LECs' ability to disrupt the development of competition is strongest. This is the wrong time to even consider procedures for streamlining or nondominant status.

I. SINCE THE ELIMINATION OF SHARING WILL NOT ACHIEVE A "PURE" PRICE CAP, REGULATORY OVERSIGHT MUST BE MAINTAINED

Those who argue for relaxation of the price cap regulatory scheme maintain that by eliminating "sharing" the Commission will achieve a "pure" price cap and thereby remove the telcos' incentives to cross-subsidize. The truth is even if sharing were eliminated, the price cap scheme will still be "impure" because the link between prices and costs will not be completely and irrevocably severed. So long as telephone companies know that they have recourse to regulators to obtain rate changes--whether through adjustments to the rate of return in response to significant under- or over earnings or through changes in the productivity factor--they will not behave as would a competitive firm. In contrast to the competitive firm, LECs will continue to possess incentives to predatorily price competitive services and to thereby enhance their competitive position.

As a general proposition, predatory pricing is not a realistic long-term profit-maximizing strategy for the competitive firm. But the situation is different with a regulated firm that is unable to engage in profit maximization. By virtue of the regulation, a regulated firm has the incentive and ability to shift undetected costs from the competitive market to the regulated monopoly market.

Until the mid-1980's, rate-of-return regulation and telephone company rate regulation were synonymous. Rate-of-return regulation has been widely criticized because the "cost plus" approach inherent in rate-of-return regulation --the regulatory focus on the carrier's recovery of investment and expenses plus an adequate return on investment-- fosters improper cost shifting and other types of inefficient behavior.[1] The rate-of-return regulated firm may have weak incentives to operate efficiently if it can easily pass costs on to consumers in the form of higher prices. By shifting costs from the competitive to the regulated market, the competitive service can obtain a subsidy from the regulated operation. In contrast to the firm operating in a competitive environment, "the up-front costs of predatory pricing would come at the expense of ratepayers rather than of stockholders--a situation that makes predatory pricing a more plausible strategy than ... for the unregulated firm."[2]

In response to the incentives to inefficient pricing generated by rate-of-return regulation, price cap regulation has been adopted with increasing frequency by regulators at the federal and state levels. Price cap schemes are premised on the notion that by capping rates at a certain level, the firm's incentives will be increased to operate more efficiently and as if in a competitive environment. Price caps are intended to make it difficult or impossible for the firm to raise prices in its monopoly market to subsidize outside activities.

Price cap schemes, as a general matter, are an improvement over rate-of-return regulation. But the imposition of price caps in just any form cannot justify the elimination of regulatory supervision of a LEC's costs. For that to happen, the particular price cap scheme must, in the words of Professor Alfred Kahn, "break the link" between prices and observed costs. As Professor Kahn explained in an affidavit appended to a Bell Atlantic submission at an earlier phase of this proceeding:

> In its pure form direct price regulation eliminates any entitlement of regulated companies to recover from monopoly customers any reductions in rate of return

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1 See, generally, H. Averch and L. Johnson, *Behavior of the Firm Under Regulatory Constraint,* American Economic Review, December 1962.

2 Declaration of Dr. Leland L. Johnson, Dec. 8, 1995, at 8 ("Johnson Declaration").

> resulting from price cuts in competitive markets. It correspondingly eliminates any incentive of the regulated companies to shift costs from unregulated or competitive to less competitive services. *Under price caps--or any form of incentive regulation that breaks the link between observed costs and prices--the LEC is no more able to cross-subsidize than an unregulated firm: if it invests money in the destruction of its rivals, it will have to absorb that investment as a reduction in its earnings and hope to recoup its losses later under more favorable circumstances.*[3]

The key issue is whether, under a particular price cap scheme, "the link" between rates and costs will be broken.

The Commission must face squarely the regulatory challenge that arises because, in the real world, prices can never be expected to be totally divorced from costs, and "pure" price caps, as described by Professor Kahn, "do not exist, nor can they ever be expected to exist."[4] This is because the regulated firm knows that regulators will inevitably be forced to react to exceptionally high or low profit levels by adjusting rates. As a result, "real world" price caps, such as those under consideration by the Commission, should be understood as a form of rate of return regulation with a formal time lag.

"Real world" price caps are different from "pure" price caps because with real world price caps even if the rates themselves do not increase, or even if they decline, LECs will still have the incentive and ability to cross-subsidize. Under real world price caps, real prices will tend to fall over time to reflect growth in productivity. The Second Further Notice of Proposed Rulemaking in Price Cap Performance Review of Local Exchange Carriers ("Second Further

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3 Id. at 9, quoting Statement of Alfred E. Kahn, FCC CC Docket No. 94-1, June 28, 1994, at 13, in Bell Atlantic *ex parte* submission to FCC, Sept. 23, 1994 (emphasis supplied).

4 Id.

Notice")[5], which proposes a real world price cap scheme, continues the practice of adjusting the productivity factor to take account of changes in productivity over time. The particular method to calculate productivity in the long-term Price Cap Plan must await completion of the Fourth Further Notice in Price Cap Performance Review for Local Exchange Carriers ,[6] but whatever method is chosen will involve adjustments over time to take account of changes in productivity.

Thus, price caps will be subject to formal review at specified intervals "whereupon past performance is evaluated (including the historic rate of return) and adjustments made in the productivity factor and other elements in the formula to bring the projected rate of return in line with what regulators would regard as just and reasonable."[7] Professor Kahn agrees when he observes that:

> All of the schemes of which I am aware contemplate review within a few years of how they are working. Since the indexation formulas are inevitably based on estimates--in particular estimates of how the costs of the regulated companies may be expected to behave relative to the basis for indexation (such as the Consumer or GNP price index) it is difficult to imagine a scheme under which the government would surrender for all time the option of testing the accuracy of those estimates against actual experience.[8]

For this reason, "In no sense can the company's prices be regarded in the long run as frozen irrespective of costs, as would be expected in a pure price cap regime."[9]

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5 Price Cap Performance Review for Local Exchange Carriers, FCC 95-393, rel. Sept. 20, 1995 ("Second Further Notice").

6 Price Cap Performance Review for Local Exchange Carriers, FCC 95-406, rel. Sept. 27, 1995 ("Fourth Further Notice").

7 Johnson Declaration at 9-10.

8 Id. at 10, quoting Alfred E. Kahn, *Review of Regulatory Framework,* Canadian Radio-Television and Telecommunications Commission, Telecom Public Notice CRTC 92-12. Filed on behalf of AGT, April 13, 1993, at 21 (emphasis in original).

9 Id. at 10.

Since their rate reviews are dependent upon historical experience and undertaken on a periodic basis (whether through formal reviews or "moving average" adjustments), LECs can attempt to shift costs to the more inelastic services and thereby establish a basis through the review process for a revised formula (for example, adjusting the productivity factor downward) and thereby obtain authority to charge higher prices than would otherwise be permitted. Consequently, it is not enough to ensure against telephone rate *increases*. To protect against cross-subsidy, users must be assured of no smaller rate *decreases* (through smaller productivity adjustments) than they would enjoy in the absence of competition.

Certain telephone companies argue that a price cap is "pure," and there is no danger of cross-subsidy even where the amount of the productivity adjustment or "X" factor is subject to adjustment, so long as the particular price cap plan does not include a sharing mechanism. Using this definition, Bell Atlantic, for example, asserts that, because it has elected the "no sharing" option, there is no possibility that the company "could raise prices of other regulated services to subsidize below cost rates for video dialtone service."[10]

But what Bell Atlantic calls "pure" price caps is not the same thing as "pure" price caps as used by Professor Kahn and Dr. Johnson. Professor Kahn and Dr. Johnson define a "pure" price cap scheme as one that totally divorces prices from costs, fixing the productivity factor once and forever and placing its calculation outside of the individual firm's control. Real world price cap schemes, in contrast, contemplate that individual firm prices will be adjusted to reflect

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[10] Reply of Bell Atlantic, Amendment to the Bell Atlantic Telephone Companies, Tariff No. 10 (Video Dialtone Service for Dover Township, New Jersey), May 19, 1995, at 2.

the individual firm's costs, for example by incorporating mechanisms that provide for adjustments in the individual firm's productivity factor.

Under the Commission's plan, these adjustments may occur not only at the time of a formal review. If a LEC is offered two choices, one involving sharing and the other not, and it is permitted to change course periodically and before completion of the formal review, it will be able to effectively adjust it rates. In no sense will rates be permanently capped. State price cap plans that bear similar characteristics--i.e., "impure" price caps--compound the problem.

It is also argued that the "basket" and "band" mechanisms in the price cap scheme will provide the extra layer of protection so that the risk of cross-subsidy is adequately controlled. But while the separate classification of service categories will facilitate regulatory supervision, it will not alter the fundamental incentives of a LEC to misallocate costs and to cross-subsidize more price elastic services.[11] Supposedly capped rates, whether for services as a whole or for service categories, remain subject to the gaming of the regulatory process through adjustments in productivity or, in more drastic circumstances, the rate of return.

Real world price cap schemes, in short, are not a panacea because these plans do *not* "break the link" between prices and costs. Prices will continue to reflect historical experience, and regulators will continue to examine costs when undertaking periodic rate reviews. LECs will have incentives to over allocate costs to the less elastic services, and to under allocate costs to the more elastic services. Regulation of costs will be necessary to ensure just and reasonable

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[11] The problem is particularly acute because federal and state regulatory processes provide LECs with opportunities to exploit differences in elasticity between regulated and unregulated services that use integrated transmission facilities, FCC and state regulated services, and federally regulated services "incorrectly" categorized by basket.

rates for the LECs' monopoly services until the marketplace transforms and LECs are no longer the "dominant" provider of bottleneck facilities.

II. PRICING FLEXIBILITY SHOULD BE IMPLEMENTED IN CONJUNCTION WITH STEPS TO FACILITATE A COMPETITIVE MARKETPLACE

The Second Further Notice "tentatively concludes" that LECs should receive some regulatory flexibility irrespective of the level of competition that they face, more relief in the form of "considerably more pricing flexibility"[12] under "streamlined regulation" when "actual competition" is present, and "nondominant" status and forbearance from price regulation "where a LEC is shown to lack market power."[13] The Second Further Notice further proposes to apply "nondominant" status on a service-by-service, rather than a carrier-by-carrier, basis.

At the present time, consumers have no real choices in the selection of facilities-based providers of local telephone services. "The telephone company" is the only game in town. The basic fact of the single-provider is irrefutable; to this point, it has been immutable. In this environment, granting LECs additional pricing flexibility without regard to the state of competition is not a neutral act. Rather, it enables LECs to "compete" more effectively against "ghost competitors" that do not exist, and nascent competitors that pose no serious short-term threat to the LECs' dominant position. The Commission should wait until competitive forces can displace the functions performed by regulation before it relieves LECs of rate regulation requirements.

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12 Price Cap Performance Review for Local Exchange Carriers, FCC 95-393, rel. Sept. 20, 1995, at para. 127 ("Second Further Notice").

13 Id. at para. 3.

The fundamental problem the Commission's approach is that it provides regulatory relief to LECs before competitors enter the market and the mechanisms to permit competitors to compete under fair rules have been put in place. Related proceedings concerning interconnection, access charge reform, separations reform, numbering administration, number portability, mutual compensation mechanisms and universal service, as well as the proceedings that will be needed to implement the pending legislation, are needed. The conclusions reached in these other proceedings will profoundly influence the price cap proceeding and one another, as well as influencing the pace, form and prospects for the development of competition.

If the Commission's true objective is to facilitate the development of marketplace mechanisms that can effectively replace regulatory devices at the earliest possible date (and we have no doubt that is the case), it should adopt and implement the interconnection and other prerequisites for a competitive marketplace before it grants the LECs any additional pricing flexibility. Pricing flexibility should be considered as part of the comprehensive package of actions to effectuate competition. Providing flexibility now would reduce the LECS' incentives to accommodate competition at just the moment when hoped for competition may be on horizon. With competition in its infancy, and with all of these matters in play, it is unwise to grant relief from the rate regulatory procedures that now apply.

Granting the LECs pricing flexibility now, moreover, removes a powerful incentive to comply with the interconnection and unbundling requirements that are now or soon will be under consideration. Once they have flexibility, the LECs' incentives to accommodate competition will be diminished. Seemingly putting the cart before the horse, the Commission maintains, for example, that providing LECs with certain types of pricing flexibility "will yield public benefits"[14] even "where competition has not yet arrived."[15]

As we explain below, however, the grant of pricing flexibility should be tied to competitive circumstances. By conditioning regulatory relief upon the LECs' willingness to negotiate interconnection agreements on just and reasonable terms, for example, the Commission can do its part to accelerate the development of workably competitive local telecommunications markets. The Commission should, therefore, condition any modifications to the LEC Price Cap Plan that are beneficial to LECs upon their compliance with a "competitive checklist" and the resolution of any allegations that LECs are using their capabilities as the dominant providers of local telephone service to disadvantage competitors.

A. Competitive Checklist

As the Commission acknowledges, "Basing relaxed regulatory treatment or additional pricing flexibility on the elimination of entry barriers can serve as a mechanism for encouraging LECs to open their markets to local competition."[16] In addition to resolving allegations of anticompetitive practices against LECs before according them pricing flexibility, the Commission should adopt in regulations the proposals presently incorporated in pending legislation, and the Second Further Notice, to require compliance with a "competitive checklist" as a precondition to the grant of any pricing flexibility.

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14 Second Further Notice at para. 6.

15 Id.

16 Id. at para. 107.

The Commission should affirmatively promote the elimination of barriers to local telephone service competition. The alternative, authorizing flexible pricing prior to the presence of competitive conditions, can discourage the development of actual competition by signaling the marketplace that LECs will be able to respond before competition is actually present. The result of a LEC's competitive response prior to the presence of competitive conditions may be to delay competition.

Until competitive conditions are present, telephone companies will retain the ability to use the attributes of their monopoly, including their bottleneck facilities, to disrupt competition. Until that bottleneck control is sufficiently relieved, competitors must be able to turn to the FCC and to the states to enforce fair rules of marketplace competition. Otherwise, LECs may be able to control the level of competition by opening the bottleneck only so far.

The proposals passed by both houses of Congress indicate that the new telecommunications law will provide legislative guidance on the specific issue of the checklist. The Commission will have major responsibilities to implement the new law. The gathering of comments pursuant to the Second Further Notice is a positive step, but it is not a substitute for the direction that Congress will provide upon the passage of legislation.

B. Competitive Interference

It is particularly critical that the Commission take account of the LECs' actions toward competitors before granting any regulatory flexibility, because there is abundant evidence that anticompetitive concerns are real, not merely hypothetical. The former chairman of the Illinois Commerce Commission, Terrence Barnich, speaking of LECs, recently noted that "They can virtually make competitors' lives hell."[17] The Commission should establish a procedure that permits competitors to show that they are experiencing anticompetitive conduct, and to obtain relief, prior to the LECs receipt of any regulatory flexibility.[18]

The first efforts by competitors to compete have prompted a vigorous anticompetitive response. In Grand Rapids, where Ameritech is seeking competitive status on the grounds that barriers to competition have been reduced pursuant to its Customers First plan, US Signal Corp. ("US Signal") has, according to *The Wall Street Journal*, "struggled for more than a year to get a toehold in the local telephone market."[19] The newspaper reports:

> "This is where we are," says Martin Clift, US Signal's director of regulatory affairs, as he points to a small patch of yellow covering ten downtown blocks. "This is where we want to be," he adds as he motions to the entire 238-square-mile service area. "But they won't let us."
>
> "They" are executives at Ameritech Corp., the Chicago-based regional Bell that holds a monopoly on service here in US Signal's hometown. US Signal says Ameritech has fought nearly every step of the way as the upstart tries to expand into this community of 500,000 in the heart of Ameritech territory.
>
> US Signal hoped to cover half the city by now, but has been able to lease only 1,700 of the thousands of lines it wants from Ameritech. For most of the past year, the Baby Bell has refused to let it branch out unless US Signal installs expensive gear US Signal says it doesn't need. The smaller rival accuses Ameritech of dragging its feet in processing orders, trying to levy bogus fees and refusing to refund $240,000 for services it never provided. The bickering has cost US Signal more than $1 million in legal fees -- far more than the revenue it gets in the market. US Signal Executive Vice President Brad Evans says: "We are at the end of our rope."[20]

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17 "Calls Waiting: Rivals Are Hung Up on Baby Bells Control Over Local Markets," *The Wall Street Journal,* Oct. 24, 1995, at 1(*The Wall Street Journal*).

18 To the extent price cap plans succeed in allowing telephone companies to earn higher rates of return, the incentive for such anticompetitive behavior actually increases. This is because the rewards of anticompetitive behavior can increase along with the profitability of monopoly services.

19 Id.

20 Id.

If Ameritech genuinely supported competition, this would not happen.

Ameritech has not limited its tactics to Grand Rapids. Last April, with much fanfare the company announced an agreement that would permit AT&T to lease its facilities and resell its lines in Chicago. Seven months later, Ameritech and AT&T were still in negotiations. While Ameritech got some favorable publicity from the announcement of an interconnection arrangement with U.S. Network Corp., a privately held start-up venture, a similar agreement with AT&T has not been concluded. An AT&T spokesperson remarked, "We've been negotiating with them [Ameritech] much longer than U.S. Network, and we haven't gotten anywhere. They send the wrong people to meetings, they come to meetings without being prepared and they just plain refuse to negotiate on interconnection"[21]

There are strong indications that these events are part of a deliberate strategy. One press story described the reaction of an AT&T representative, who stated: "Their [Ameritech's] strategy is delay.... We see it in every contact that we have with them."[22] While Ameritech cites its revenue-sharing arrangement with MFS as evidence to the contrary, a *Forbes* article paints a different picture: "Pointing to the MFS deal, [Ameritech Chairman Richard] Notebaert can claim that he's not against competition. He seems to be hoping that this evidence will suffice to persuade legislators to let him into the long distance business before he is forced to take on AT&T on his home turf."[23]

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21 *America's Network,* Dec. 1, 1995, at 16.

22 "Timing Is All," *Forbes, Nov. 6, 1995.*

23 Id.

The unfortunate experiences of competitors is not limited to Ameritech. Teleport Communications Group, Inc. ("TCG") has encountered similarly dilatory tactics in its efforts to compete with NYNEX in New York, and has been forced to seek relief at the Commission and the New York Public Service Commission. According to a recent press report, TCG and NYNEX entered into a much-heralded mutual compensation and interconnection agreement in June 1994.[24] Subsequently, TCG has experienced major impediments that have slowed the development of its competitive services. A separate press report noted:

> NYNEX Corp. last year touted itself as the first Bell to sign a contract letting a competitor hook up directly to its network. But ...[more recently]... the rival, Teleport Communications Group, asked New York state regulators to investigate Nynex's attempt to stifle local telephone competition. The pact was supposed to be implemented within 60 days. Sixteen months later, most of the terms still haven't gone into effect.[25]

The TCG-NYNEX interconnection agreement contemplated NYNEX would provide intercarrier trunks for terminating interLATA traffic that may be "one way or two way." Following the installation of the first 111 trunks, according to TCG,

> NYNEX-New York began requiring that all trunks be provisioned as one-way, which TCG said is inefficient and expensive. TCG also said that NYNEX-New York has forced it to construct an "extremely expensive and technically inefficient dual-trunking network to accommodate meet-point billing arrangements." NYNEX-New York has refused to order the trunking arrangements required to originate intraLATA "800" calls and deliver them to the telco, TCG added.[26]

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[24] "TCG Says NYNEX-New York Stifles Competition." Telecommunications Reports, Oct. 23, 1995, at 15 ("Telecommunications Reports").

[25] *The Wall Street Journal,* Oct. 24, 1995, at 1.

[26] Telecommunications Reports, at 15-16.

TCG also accused NYNEX, *inter alia,* of failing to meet several agreed upon billing arrangements and refusing to provide necessary billing information.[27]

NYNEX's actions have also forced TCG to seek the Commission's assistance in obtaining NXX code assignments. TCG maintains that NYNEX has refused to provide TCG with codes in the "212" and "718" numbering plan areas ("NPA") that are needed to provide interstate and intrastate services. NYNEX satisfied only a portion of the request and informed TCG that it would have to reapply before more codes were made available. This response will presumably provide NYNEX with new opportunities to delay TCG's plans to compete.

In still another example of NYNEX's NXX code strategy, the telco denied TCG's request for NXX codes in the Bronx in New York City on the grounds that TCG did not have a point of interconnection in the '718' NPA. TCG told the Commission that the existing guidelines do not require that TCG have an interconnection point in a particular NPA in order to receive NXX codes to serve the area. TCG also noted that NYNEX "has assigned NXX codes to itself, to TCG, and to another competitive access provider to serve locations from points of interconnection in other NPAs."[28]

Ameritech and NYNEX have been outspoken in their alleged willingness to face competition. They have also been aggressive in seeking relief from regulatory constraints on the ground that they are subject to competition. The above reports suggest a wide gap between Ameritech and NYNEX claims respecting the state of competition and their actual commitment to competitive principles. Were the Commission to rely on these telcos' assertions about

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27 Id. at 16.

28 Id. at 16.

competition at face value, the agency might become an unwitting abettor in the telcos' long-term goal to maintain domination of their local telephone markets.

Moreover, the Commission would be wrong to view the tactics of Ameritech and NYNEX as new inventions limited to these carriers in this circumstance. The record of the AT&T antitrust case is replete with examples, similar to the ones described above, of LECs taking advantage of control over essential local distribution arrangements to delay the advent of competition, and of efforts by the incumbent carriers to raise rivals' costs. Each small step by the new entrant was greeted by LECs determined to make competitive entry as difficult as possible. The story being told by competitors' experience with Ameritech and NYNEX is not an original production; it is the revival of a long-running play.

The Commission must make clear now, as it did in the early days of long distance competition, that telephone company practices of this sort will not be tolerated. Two decades ago, the attempts by AT&T and the Bell Operating Companies to disrupt incipient long distance competition were met by the Commission with regulations and procedures that set the interexchange transmission business on a competitive course.[29] The success of that policy was confirmed when the Commission declared AT&T "nondominant."

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[29] See Bell System Tariff Offerings, 46 FCC 2d 413, 435-36 (1974); aff'd sub nom. Bell Telephone Company of Pennsylvania v. FCC, 503 F.2d 1250 (1974) ("We find and conclude that Bell engaged in conduct which has resulted in the denial of, or unreasonable delay in establishing, physical connections with ... specialized common carriers...; that it pursued policies and practices which foreclosed the establishment of through routes, and the charges, facilities and regulations applicable thereto in connection with authorized services of ... specialized carriers; ... and that Bell has discriminated against ... specialized carriers in favor of its own Long Lines Department by denying to ... specialized carriers the interconnection privileges presently provided to said Long Lines Department in connection with authorized interstate services. We further conclude that the aforementioned conduct and practices are in violation of the Act, and the declared policy of the Commission; and that the public interest requires the issuance of orders requiring Bell to cease and desist from further violations.")

Technological and marketplace forces appear to present genuine possibilities for workably competitive local telephone services. Unfortunately, however, competition will not just happen. Existing arrangements can disrupt the normal marketplace evolution, unless the Commission acts. The agency can and must play a constructive role, similar to the role it played in an earlier time, to define and enforce "fair rules" of competition.

As a supplement to an appropriately crafted "competitive checklist," and as a precondition to regulatory flexibility discussed in the next section, the Commission should adopt an additional procedure to take account of the situations in which LECs use the attributes of their monopoly to impede competition. LEC competitors should be given an opportunity, through the formal complaint process or some other process that the Commission devises, to protest anticompetitive practices that interfere with their market entry and otherwise disrupt their competitive plans. The Commission should require filings submitted pursuant to this procedure to be made within a limited period following the alleged difficulty, and to be resolved promptly by Commission order. During the pendency of a controversy, a LEC should not be entitled to any regulatory relief. By adopting this process, making it available to LEC competitors and letting LECs know that it has genuine "teeth," the Commission will make a major contribution to speeding the development of local telephone service competition

III. EVEN WHERE LECS ARE NOT ATTEMPTING TO BLOCK COMPETITION, THE PROPOSED MODIFICATIONS TO THE LEC PRICE CAP PLAN GO TOO FAR TOO FAST

It is beyond dispute that regulation that is unnecessary or inefficient should be eliminated. It is equally certain that unnecessarily complex regulation should be simplified. At the same time, however, prudence dictates that the Commission, at this critical transition point toward competition, not remove the necessary procedures to protect consumers and to facilitate the transition.

The Second Further Notice explicitly acknowledges this concern. In addition to satisfying a "no impeding of competition" test outlined in Section II, the proposed changes and any others offered by the LECs, should be measured against the standard that the Commission articulates. The agency states:

> As we consider the possible changes discussed in this Notice, we do not want to relax regulation so much that consumers will be harmed by monopoly pricing or allow LECs so much flexibility that they could recoup foregone revenues from more competitive services with revenues from less competitive services, or engage in predatory pricing, unlawful discrimination, or other anticompetitive practices.[30]

The Commission's proposals for modification of the Price Cap Plan will pose unacceptable risks in this regard. Furthermore, implementation of the proposed modifications should not be adopted before essential competitive procedures, including interconnection, network unbundling, mutual compensation arrangements, number portability, dialing parity, universal service and modifications to access charges and separations procedures are in place. Changes to price cap regulation should be undertaken, if at all, as part of a comprehensive modification of telecommunications regulation. In other words, this proceeding should go forward only as part of the implementation of telecommunications legislation and the resolution of related matters by the Commission.

The Commission seeks comment on (1) the elimination of lower service band index limits; (2) the modification of procedures for implementing new services and rate changes in

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30 Second Further Notice at para. 37.

the form of (a) new services and restructures, (b) alternative pricing plans, and (c) individual case basis tariffs; (3) changing the existing procedure for obtaining Part 69 waivers; (4) revision of baskets; and (5) consolidation of service categories. The following comments demonstrate that, except for the proposal concerning individual case basis tariffs, the Commission should not make any of the proposed changes at this time.

A. Lower Service Band Index Limits

The Commission proposes to eliminate lower service band index limits for all service categories in both the traffic sensitive and trunking baskets. The Second Further Notice explains that "The lower service band index limits were designed to prevent LECs from lowering their prices below cost in order to thwart competition and then raising them after competitors have been driven from the market."[31] The Commission reasons that upper bound limitations on the LECs' ability to increase prices, and the tariff review and formal complaint processes, can serve as disincentives to engage in predatory pricing. The Commission further observes that elimination of lower service band limits will "allow price cap LECs to move prices more quickly toward costs in situations where they may be inhibited from doing so."[32]

In essence, adoption of the Commission's proposal would shift the burden of proof to demonstrate that LEC rates are predatory from the predator to the prey. The Commission rationalizes that this proposal will allow "price cap LECs to move prices more quickly toward costs."[33]

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[31] Id. at para. 83.

[32] Id. at para. 84.

[33] Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786 (1990).

The Commission should not adopt this proposal. As explained in the Johnson Declaration, price capped LECs retain incentives to engage in predatory pricing. The general rule accepted by economists that a firm will not engage in predatory pricing over the long term does not apply to the regulated firm able to shift costs from a relatively price elastic to a price inelastic service.

It is no answer that the elimination of the lower service band index limits will permit LECs to move prices more quickly *toward* costs. That was not the purpose of the lower service band limits. The Second Further Notice states "The lower service band limits were designed to prevent LECs from lowering their prices *below* cost in order to thwart competition and then raising them after competitors have been driven from the market."[34] The Commission should not adopt a procedure that will more easily permit LECs to price *below* cost if its true goal is to encourage cost-based pricing.

Of course, as a matter of principle if a LEC has been pricing above cost, the Commission's procedures should provide for reductions to cost. Cost-based rates are not predatory rates. On the other hand, there is no justification (and the Second Further Notice offers none) for predatory rates. The Commission should not use the goal of *cost-based* rates to rationalize a procedure that shifts the burden of proof from the carrier to competitors to show that rates are not *predatory*.

The process of affording LECs flexibility to move currently above-cost rates to cost further points up the importance of including an analysis of costs in the review of rates. Where LECs choose to lower rates to cost, the Commission must be in a position to determine that the

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[34] Id. at para. 83 (emphasis supplied).

reductions are not to predatory levels. The only way this can be accomplished is by maintaining a review process that analyzes the relationship of rates to costs.

B. New Service Offerings and Restructured Services

1. New Services

The Commission adopted the "new services test" procedure as part of the 1990 LEC Price Cap Order[35] because new and restructured services "present different issues ... [and, therefore] ... must undergo separate forms of regulatory analysis."[36] As part of the 1990 ruling, the agency decided that new services would be held outside price caps for some initial period "in order to enable LECs to establish the historical demand figures ... for computation of ... price cap formulas."[37] During this initial period, the Commission intends to examine the impact of the new services "on the revenues of capped services."[38] The Commission adopted a "net revenue test" for the pricing of new services that, according to the agency, "will assuage concerns in those service markets for which the LECs are subject to competition, *e.g.*, high capacity facilities in urban areas, new services might enable a LEC to propose predatorily or discriminatorily low rates to certain customers."[39]

The new services procedure, and the "net revenue test" of which it is a part, have not assuaged the concerns of the cable industry. In the context of video dialtone, for example, the new services procedure has been employed as an excuse to avoid the hard policy issues that arise

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[36] Id. at 6824.

[37] Id. at 6825.

[38] Id.

[39] Id.

when telephone companies propose to construct integrated plant to deliver telephone and video services. The Commission should take this opportunity to reevaluate its conclusion that video dialtone services qualify as "new services," at least in the traditional sense, for purposes of the Price Cap Plan.[40]

In the Second Further Notice, the Commission proposes to adopt a two-track procedure that would distinguish "new services," maintain the existing oversight of services qualifying within the first track and reduce oversight of services coming within the second track. Comment is sought on whether to apply reduced oversight based on a demonstration of "competitive circumstances" or on "the nature of the services themselves,"[41] and the basis for the determination.

NCTA endorses the "competitive circumstances" approach. As explained above, until "competitive circumstances" are present to replace regulation, pricing flexibility will tend to deter the development of competition. Like the "dominant/non-dominant" scheme of Competitive Carrier, a two-track new services test premised on competitive circumstances will reduce regulatory oversight when the marketplace justifies the change. Until that happens, the existing procedures remain necessary.

2. Restructured Services

The Price Cap Plan distinguishes new services from restructured services on the basis that new services "expand the range of services available," while a restructured service "replaces

[40] Video dialtone is not, of course, just any "new service." As the projects of Bell Atlantic in Dover Township, New Jersey, and The Southern New England Telephone Company in Connecticut demonstrate, to deliver video dialtone service a telephone company must construct an entirely new network at massive additional expense.

[41] Second Further Notice at para. 46.